CHANGE OF CONTROL (AGGREGATION OF HOLDINGS) INSTRUMENT 2011

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the power in section 157(1) (Guidance) of the Financial Services and Markets Act 2000.

Commencement

B. This instrument comes into force on 6 February 2011.

Amendments to the Handbook

C. The Supervision manual (SUP) is amended in accordance with the Annex to this instrument.

Citation

D. This instrument may be cited as the Change of Control (Aggregation of Holdings) Instrument 2011.

By order of the Board
19 January 2011

Annex

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text, unless otherwise stated.

11.3.1A G For the purposes of Part XII (Control over authorised persons) of the *Act*, and in particular, calculations relating to the holding of shares and/or voting power, the definitions of "shares" and "voting power" are set out in section 191G of the *Act*.

11.3.1B G *SUP* 11 Annex 6G provides *guidance* on when one *person*'*s* holding of *shares* or *voting power* must be aggregated with that of another *person* for the purpose of determining whether an acquisition or increase of control will take place as contemplated by section 181 or 182 of the *Act* such that notice must be given to the *FSA* in accordance with section 178 of the *Act* before making the acquisition or increase. This will be:

(1) where those *persons* are acting in concert, as contemplated by section 178(2) (Obligation to notify the Authority: acquisitions of control) of the *Act*; or

(2) in the case of voting power only, if any of the circumstances described in section 422(5) (Controller) of the *Act* apply.

After SUP 11 Annex 5, insert the following new annex. The text is not underlined.

11 Annex 6G Aggregation of holdings for the purpose of prudential assessment of controllers.

Q1: What is this guidance about?

A: This guidance considers when one *person*'s holding of shares or voting power must be aggregated with that of another *person* for the purpose of determining whether those persons have decided to acquire or increase control over a UK authorised person, as contemplated by section 181 or 182 of the *Act*, such that notice must be given to the *FSA* in accordance with section 178 (Obligation to notify the Authority: acquisitions of control) of the *Act* before making the acquisition or deciding to increase their control.

Q2: When are shares or voting power to be aggregated?

A: There are two situations which would require the holdings of two or more *persons* to be aggregated for the purpose of determining whether they are acquiring or increasing control within the meaning of section 181 or 182 of the *Act*. The first is where shares or voting power are held or to be held by persons 'acting in concert' – this is referred to in sections 178(2) and 422(3) of the *Act*. The second is where a *perso*n (H) is attributed with voting power in a *firm* through the application of any of the circumstances described in section 422(5)(a) of the *Act* ('deemed voting power') in addition to any

other voting power that he holds (or is deemed to hold) in that *firm*. These two situations may apply concurrently. For example, H could be acting in concert pursuant to section 178(2) of the *Act* and have deemed voting power under section 422(5)(a)(i) of the *Act* where H has concluded an agreement that obliges him and a third party shareholder in the *firm* to adopt, by concerted exercise of the voting power they hold, a lasting common policy towards the management of that *firm*.

Acting in Concert

Q3: What does 'acting in concert' mean for these purposes?

A: There is no definition of this phrase in the *Act*. The Glossary to the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC (the 'Acquisitions Directive') published jointly by CEBS, CEIOPS and CESR (the 'Level 3 Guidelines') states that, for the purposes of the Acquisitions Directive, 'persons are "acting in concert" when each of them decides to exercise his rights linked to the shares he acquires in accordance with an explicit or implicit agreement made between them.' The relevant persons must therefore (1) hold shares and/or voting power in the *firm* or its *parent undertaking*, and (2) reach a decision to exercise the rights linked to those shares in accordance with an agreement (in writing or otherwise) between them.

While the rights 'linked to' shares for these purposes are most likely to be voting rights, persons may be 'acting in concert' where they decide to exercise other share-related rights, either in addition to or instead of voting rights, in accordance with an agreement made between them. As indicated in the Level 3 Guidelines, persons will begin acting in concert when they take the decision to exercise their rights in accordance with an agreement between them. This decision may be taken before or after the time the relevant persons decide to purchase shares in the *firm*. The agreement need not require them always to exercise the rights attached to their respective shares in the same way – see, for example, the response to Question 11 in respect of passive shareholdings.

Q4: Does section 178(2) of the Act have the effect that two or more persons who already hold shares or voting power in a firm or its parent undertaking and who subsequently decide to exercise their voting or other rights in accordance with an agreement between them are required to give prior notice under section 178(1) of the Act, if their aggregated holdings fall within any of the cases set out in section 181(2) of the Act or increase by any of the steps set out in section 182(2) of the Act?

A: Yes. Section 178(1) of the *Act* applies when a *person* 'decides to acquire or increase control over a UK authorised person…'. For the purposes of Part XII of the *Act*, a *person*'s acquisition of control of a *firm* is determined by virtue of his holdings of shares or voting power in that *firm* or in a *parent undertaking* of that *firm*. In determining whether control has been acquired, section 178(2) of the *Act* requires the holdings of shares or voting power of *persons* who are acting in concert to be aggregated. As noted in the response to Question 3, *persons* begin acting in concert when they decide to exercise their voting or other rights in accordance with an agreement between them. Once this decision has been taken, shares or voting rights must be aggregated to determine whether control has been or will be acquired. The

same analysis applies to increases in control and reductions in control, as set out in sections 182 and 183 of the *Act*, respectively. Accordingly, the requirement to aggregate holdings of shares and/or voting power under section 178(2) of the *Act* may apply to existing holdings, as well as to new purchases, of shares and/or voting power.

Q5: What types of arrangement amount to acting in concert in acquiring or holding shares or voting power for the purposes of these Sections of the Act?

A: Although the term 'acting in concert' has a potentially wide meaning, not all common actions taken by shareholders in relation to shares or voting power will require the aggregation of holdings of shares or voting power for the purposes of section 178 of the *Act*. In particular, there are many circumstances in which *persons*, who between them hold 10% or more of the shares or voting power in a *firm* or its *parent undertaking*, may engage in a concerted exercise of voting power, without this amounting to 'acting in concert' in a manner requiring aggregation of their holdings under section 178(2) of the *Act*. An agreement by one shareholder to vote with other shareholders on a specific issue, for example, rather than on an ongoing or sustained basis, would not generally be regarded by the *FSA* as acting in concert so as to require a section 178 notice to be given by that group of shareholders, even where the group collectively holds 10% or more of the voting power in the *firm*. However, see further on this point in the response to Question 9.

Deemed voting power

Q6 : What is meant by 'deemed voting power'?

A: 'Deemed voting power' is the term used in this guidance to describe those cases set out in section 422(5)(a) of the *Act* in which one *person*'s holding of voting power is attributed to another. There may be circumstances in which deemed voting power must be aggregated with other (actual or deemed) voting power for the purposes of determining whether section 181(2)(b) of the *Act* applies, but the cases set out in section 422(5)(a) may result in the attribution of voting power to a *person* (H) without aggregation where H holds no other actual or deemed voting power in the relevant firm and is not acting in concert with any other person (for example, where H exercises the voting power attaching to shares deposited with him pursuant to a discretion granted to him in the absence of (1) specific instructions from the actual shareholders, and (2) any agreement with the shareholders as to how he should exercise that voting power or any other rights attached to those shares - see section 422(5)(a)(vi) of the *Act*).

The provisions of section 422(5)(a) of the *Act* were transposed into the *Act* in order to implement Directive 2004/109/EC (the 'Transparency Directive'). These provisions have direct application to Part XII of the *Act*, and in particular to the meaning of 'voting power' for the purposes of that Part, by virtue of section 191G (Interpretation) of the *Act*.

In introducing the cases in which the voting power of a third party may be attributed to H, the Transparency Directive refers to the ability 'to acquire, to dispose of, or to exercise voting rights in any of the [relevant] cases or a combination of them.' No new purchase of shares is therefore required in order for these attribution provisions to apply.

Q7: Where X holds 10% of the voting power in a firm and X is the subsidiary of H, which itself has no holding at all directly in the firm, is H a controller?

A: Yes. This follows from section 422(5)(a)(v) of the *Act*, which provides that voting power includes, in relation to a *person* (H), voting power held by a subsidiary of H. The voting power held by X is attributed to H, making H a *controller*.

For the purposes of section 178 of the *Act*, both H and its subsidiary, would be required to notify and obtain the *FSA's* approval prior to acquiring or increasing control.

Practical application of aggregation of holdings

Q8: Does there need to be a new purchase of shares or voting rights in order for the notification requirement to arise?

A: No. As stated in the response to Question 4, the aggregation of shares and/or voting power is relevant to existing holdings of shares and/or voting power where no new purchase is to take place, as well as to new purchases.

Q9: Do the aggregation provisions apply to shareholders agreeing how they will vote on a particular issue, for example, for reasons of good corporate governance?

A: We would not generally regard shareholders as acting in concert for the purposes of section 178(2) of the *Act* or as having deemed voting power requiring aggregation pursuant to section 422(5)(a)(i) of the *Act* simply because they have agreed to vote together on a particular issue, for example:

- rejection of a proposal for the remuneration of directors;
- appointment/removal of a particular director; or
- approval/rejection of an acquisition or disposal proposed by the *firm*'s board of directors.

However, there may be circumstances in which voting together on a specific issue would amount to acting in concert for these purposes. Where, for example, shareholders who have no previous agreement in relation to the exercise of their voting rights agree to act together for the purpose of voting through the resolution(s) required to enable them to obtain control of the board of a *firm*, that is likely to constitute acting in concert for these purposes, although it may not fall within section 422(5)(a)(i) of the *Act*, if those shareholders have no 'lasting common policy' towards the *firm's* management.

Those circumstances are likely to be exceptional and, while it is not possible in this guidance to give a definitive list of how they might arise, the *FSA* remains willing to provide *firms* with individual guidance on the point in cases of uncertainty.

Q10: What about agreements that specific issues will be put to a vote of shareholders?

A: An agreement that does no more than require particular management actions to be put to a vote of shareholders, such as major acquisitions, disposals or new issues of shares, would not of itself trigger the requirement to notify. This is because there is no

agreement as to how the shareholders will exercise their rights on, or whether the shareholders will adopt a common policy towards, those proposals. An agreement which gives certain shareholders veto rights over key decisions by the *firm* may, however, bring those shareholders within the ambit of section 178(1) of the *Act* regardless of whether they are acting in concert, by virtue of their being able to exercise significant influence over the management of the *firm* – see section 181(2)(c) of the *Act*.

Q11: What about agreements as to how to exercise voting power on future issues generally?

A: This would involve acting in concert, and thus require the aggregation of holdings by the parties to the agreement, for the purposes of section 178 of the *Act*. It may also fall within the ambit of section 422(5)(a)(i) of the *Act*, but this will depend on whether the parties to the agreement have adopted a lasting common policy that relates to the management of the relevant undertaking.

Acting in concert not only covers agreements to exercise voting power, but may also arise as a result of 'passive shareholder agreements'. In these, a shareholder (the 'passive shareholder') agrees explicitly or implicitly with another shareholder or group of shareholders (the 'active shareholder') that it will not exercise its voting power. For example, where the passive shareholder holds 2% of the voting power and the active shareholder holds 9% of the voting power, each would be regarded as having control (11% of the voting power) because their holdings are required to be aggregated under the acting in concert provisions. However, persons that acquire shares as part of an investment or hedging programme and adhere consistently to a stated policy of not voting those shares would not, by reason of that policy alone, be regarded as having entered into an agreement with other shareholders and so would not be regarded as acting in concert with them.

Q12: Are multiple purchasers of shares, who are each party to a share purchase agreement and whose combined shareholding will fall within section 181(2) of the Act, required to give notice pursuant to section 178(1) of the Act, on the basis that the existence of the agreement means they are acting in concert?

A: If it is clear that the only 'agreement' between one or more persons consists in their being parties to the same share purchase agreement, the terms of which pertain strictly to the purchase of shares and do not govern or otherwise seek to regulate the purchasers' relationship with each other following completion of the share purchase, those purchasers would not be regarded by the *FSA* as acting in concert for the purpose of requiring notification under section 178 of the *Act*. If, however, the share purchase agreement contains provisions governing or otherwise regulating the exercise of the rights linked to the shares to be acquired by the purchasers (or the purchasers have entered into or propose to enter into a shareholders' or other agreement with similar effect), the proposed acquirers may be regarded by the *FSA* to be acting in concert for the purpose of requiring notification under section 178 of the *Act*, depending on the terms of the relevant agreement(s). Further guidance on the effect of some of the typical provisions included in shareholders' agreements is contained in the response to Question 14. Prospective shareholders who are uncertain as to the effect of any of the provisions of their agreement(s) in these circumstances may wish to seek (either formally or informally) individual guidance at an early stage from the *FSA*.

Where there is evidence to suggest that the parties do in fact intend to co-operate in relation to the exercise of voting or other rights relating to the shares they are acquiring, notwithstanding that no provisions to that effect appear in the share purchase or other written agreement, this may warrant the conclusion that there is an implicit agreement between them by virtue of which they are acting in concert.

Q13: What about agreements that are conditional on any necessary approval by the FSA?

A: Notice must be given under section 178(1) of the *Act* before control is acquired. The point in time at which this occurs may depend on a number of circumstances. In the context of a share purchase agreement that provides for *FSA* approval of the purchaser to be obtained before the acquisition is completed, the purchaser will not usually be required to give a section 178 notice prior to entering into the agreement. However, there may be circumstances in which control is actually acquired at the time the agreement is entered into, for example, where the parties have agreed that the purchaser will be entitled (whether by virtue of a power of attorney contained in the agreement or otherwise) to exercise the voting rights attached to the shares being acquired in the period between signing and completion. In that case, the purchaser will need to consider whether to give notice under section 178(1) prior to entering into the agreement.

Q14: What about pre-emption rights, 'drag along' rights and 'tag along' rights?

A: Typical examples of these arrangements are unlikely to trigger the requirement to notify under section 178(1) of the *Act* in themselves.

Bare pre-emption rights will simply indicate each shareholder's (the 'offeror') agreement to give fellow shareholders an option to purchase his shares, if he wishes to sell. The acquisition of shares under these arrangements cannot take place until the offeror decides to sell his shares and other shareholders decide to buy them.

Shareholders will not usually be regarded as acting in concert in holding or acquiring shares simply by agreeing to give each other future pre-emption rights. In the event that some shareholders enter into an agreement to buy the offeror's shares, those shareholders are only likely to be regarded as acting in concert by virtue of that agreement in the circumstances described in the response to Question 12 above.

The existence of 'drag along' and 'tag along' rights in a shareholders' agreement designed to ensure equivalent treatment of shareholders of the same class in the event an offer is made, or to be made, by a non-shareholder to purchase the shares of any single shareholder in a private company would not, in and of themselves, result in the shareholders who have the benefit of those rights being considered to be acting in concert in their holding or acquiring of shares.

Q15: How does this guidance relate to the definition of 'acting in concert' in the Takeover Code (the 'Code')?

A: Although similar terminology may be used, the definition of 'acting in concert' in the Code derives from the Takeovers Directive and has particular relevance in determining whether the relationship between persons with interests in shares carrying voting rights is such as to require those rights to be aggregated for the purpose of assessing whether, under Rule 9.1, the threshold for the making of a mandatory offer to all other shareholders in a company to which the Code applies has been reached. The notes on the definition in the Code and on Rule 9.1 make clear that the Takeover Panel's views in relation to acting in concert '…relate only to the Code and should not be taken as guidance on any other statutory or regulatory provisions'.

This guidance is given for a quite different purpose. It is relevant to considering whether the holdings of persons who have reached an agreement in relation to the shares or voting rights they do or will hold must be aggregated for the purpose of determining whether they are subject to the requirements for prudential assessment specified in sections 185 *et seq* of the *Act*. This guidance has no relevance to how 'acting in concert' is to be interpreted in the context of the Code.